

Legislative Budget Analysis

2009 Biennium



Volume 1 – Statewide Perspectives

Presented to the Sixtieth Legislature

Submitted by the
Legislative Fiscal Division

Legislative Finance Committee

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December 2006

Members of the Sixtieth Legislature:

I submit for your consideration a fiscal analysis of the state budget outlook for the 2009 biennium and Governor's Executive Budget. It is our goal that this analysis will provide the information and insight necessary for legislators to craft an effective state budget and fiscal policy for the 2009 biennium. This seven-volume report includes:

- Volume 1: Statewide Perspectives – This volume provides a summary overview of the state fiscal outlook and the executive budget analysis as well as a general reference section
- Volume 2: Revenue Estimates – This volume provides the revenue estimates and underlying economic assumptions included in the revenue estimate resolution (HJR 2), and is designed as a working document for the taxation committees
- Volumes 3 through 7: Agency Budgets – These volumes are designed to serve as working documents for the appropriations subcommittees. They provide:
 - The Governor's agency budget recommendations
 - The Legislative Fiscal Division's detailed descriptions and analysis of the various components of the Executive Budget

We appreciate the excellent cooperation of the Office of Budget and Program Planning and agency staff during the budget analysis process.

I am indebted to an exceptional LFD staff for their thousands of extra hours and dedication in preparing this analysis. Their dedication and professionalism are a credit to the Legislature and the citizens of Montana.

Your staff of the Legislative Fiscal Division look forward to being of service to the legislature during the 2007 session. We welcome any opportunity to assist you in obtaining the best possible fiscal information to facilitate setting fiscal policy. Staff names, assignments, and phone extensions are listed on page vii. Please feel free to call on us!

Respectfully submitted,

Clayton Schenck
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INTRODUCTION

PURPOSE OF THE REPORT

The purpose of this report is to provide legislators with the information needed to aid them in the crafting of a state budget and fiscal policy, and in reflecting their priorities in the 2009 biennium general appropriations act and other appropriations bills. This report seeks to accomplish this by providing an objective perspective on the state's fiscal condition and a review and perspectives on the Governor's Budget, as well as identifying and providing options for some of the major issues facing the 60th Legislature. In addition, this document is a reference document for all legislators, providing a myriad of information about state government.

WHAT IS CONTAINED IN THIS REPORT

The *Legislative Budget Analysis, 2009 Biennium* is published in seven volumes. Volumes 2 through 7 report the results of the Legislative Fiscal Division's detailed analysis of state programs and activities, while Volume 1 presents a broad fiscal overview and a discussion of the most significant fiscal issues, many of which are statewide or cut across program or agency boundaries.

Volume 1

- *Volume 1*, which includes a legislative summary, provides an overview of the proposed budget. *Volume 1* also summarizes significant fiscal issues that may impact more than one agency or that do not fall under the jurisdiction of a single appropriation subcommittee.

The "2009 Biennium Budget Overview" section on pages 3 through 12 provides a high level summary of the material presented in *Legislative Budget Analysis*.

This volume is structured to present a general fund outlook for the 2007 biennium and 2009 biennium, an analysis of the *Governor's Executive Budget* proposals, including issues identified by the LFD analysis, and a discussion of other fiscal issues that are related to the budget deliberations. The reference section, at the end of *Volume 1*, presents a range of budget-related material. This section is considered especially useful for new legislators and those who have not previously had direct involvement in the appropriations process.

An index in the back of *Volume 1* is the most comprehensive for the purpose of searching for information in all four volumes.

Volume 2

Volume 2 includes a summary and overview of the state's major revenue sources. A review of the table of contents will give the reader a quick idea of revenue sources included and the structure of the report. This volume will be provided to the House and Senate Taxation committees for use as a working document, and delineates the economic assumptions used to derive revenue estimates

adopted by the Revenue and Taxation Interim Committee (RTIC) and introduced in the revenue estimate bill (HJR 2).

Volumes 3 through 7

Volumes 3 through 7 offer detailed analyses of individual agency budgets, as proposed through the Governor's Executive Budget submitted in mid-November. These volumes feature program-by-program detail, as well as the LFD analysis of each agency budget. Agency presentations are grouped in sections corresponding to the appropriations subcommittee addressing the agency.

Volume 3 contains section A – General Government and Transportation

Volume 4 contains section B – Health and Human Services

Volume 5 contains section C – Natural Resources and Commerce

Volume 6 contains section D – Corrections and Public Safety

Volume 7 contains section E and F– Education and Long-Range Planning, respectively

A specific agency can be located in any of three ways. The general index included in each volume provides an alphabetical listing of agencies and other topics, in conjunction with appropriate volume and page numbers. If the subcommittee addressing a given agency is known, the cover page of each section lists agencies, in order by appearance. Agency names are also visible on page headings within their respective sections.

Volumes 3 through 7 briefly describe the agencies from all three branches of state government, as well as each program within an agency. The basic structure used for the analysis is consistent across agencies. These volumes detail an agency's requests, as well as a list of proposals and issues significant to the agency. When appropriate, there may be discussion of circumstances that could hold budgetary impacts (e.g., proposed executive legislation or agency reorganization). These volumes also present detailed discussions of present law adjustments, new proposals, and significant issues facing the various agencies as identified by legislative fiscal analysts.

Agency budgets are presented in three tiers as required by statute:

1. **Base budget:** the level of funding authorized by the previous legislature;
2. **Present law base:** the additional level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature; and
3. **New proposals:** requests to provide new non-mandated services, to change program services, to eliminate existing services, or to change sources of funding.

By making this presentation in this tiered manner, legislators can use the "base budget" as the starting point, then to follow the incremental increases that result in a total budget request for an agency.

Proprietary Rate Setting

HB 576 (1995) removed the requirement that proprietary – or internal service and enterprise – funds be appropriated by the legislature. Instead, the legislature approves the rates charged for those particular services and products. HB 576 also requires the Office of Budget and Program Planning to submit a report as part of the Executive Budget. This report includes fees and charges, projected fund balances, retained earnings, and contributed capital for providers. Although the legislature does not appropriate funds for the operation of these programs, it does approve the rates charged. These reports and the LFD analysis of the reports are included in the agency presentations in Volumes 3 through 7, as appropriate.



THE BIG PICTURE – AN EXECUTIVE SUMMARY

PURPOSE/CHALLENGES

PURPOSE

The purpose of this section is to provide an executive summary of Volume 1, “A Statewide Perspective”. It is intended to provide a stand-alone, big picture understanding of the state general fund budget outlook and the Governor’s budget proposal. It includes a look at the following:

- Major fiscal challenges that the Governor and Legislature need to address
- The fiscal outlook for the state general fund (how much money is available, and why?)
- The Governor’s major proposals to address budget challenges and his priorities
- Issues related to the Governor’s budget proposal and other fiscal issues

The details behind the information presented in this section are discussed in detail in the body of this volume. Readers are encouraged to delve further into these issues to better understand the budget challenges and issues the legislature will address in crafting the state budget.

BUDGET OUTLOOK/CHALLENGES

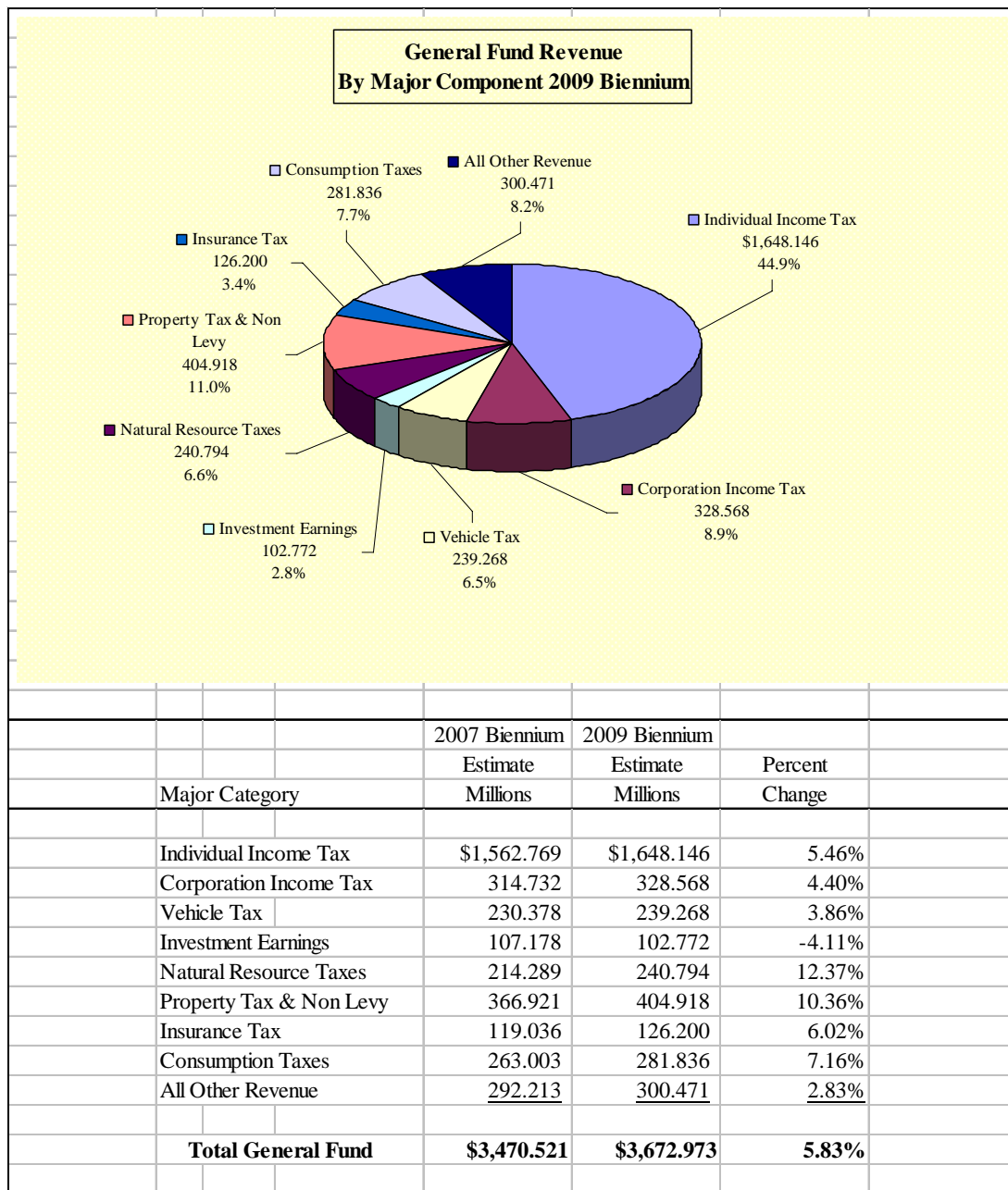
Following a biennium (2005) in which significant service reductions were taken, some major revenue sources have taken a surprising turn. Bolstered by greater than expected individual/corporate income tax and oil/gas collections, state revenues have increased, leaving a sizable projected fund balance as of the end of FY 2007/2009. However, there is also strong pressure for increased funding for state services. Even though there are record funds available, prioritization and the appropriate level of budget spending will be a hotly contested issue. There are significant budget challenges the legislature must address in setting budget priorities for the 2009 biennium. Those challenges are listed here are discussed in detail in the next section:

- Is K-12 education adequately funded?
- Does this budget control health care costs and increase access?
- How are correction costs for prison overpopulation addressed?
- Can college tuition increases be slowed to improve affordability?
- Are state employees fairly compensated and does the pay plan retain a quality workforce?
- Will all pension plans be actuarially sound?
- How will the state catch up on maintenance of state facilities?
- Can the state absorb adverse litigation outcomes?
- How will the state adjust to lost federal funds?
- Is long-term budget stability attainable?
- What is an adequate fiscal safety net?
- How will the state manage uncertainties in budgeting?
- How can the legislature attain better scrutiny over spending increases?

With these challenges in mind, the following sections discuss the revenue measures to address these issues, the Governor’s proposals to deal with these issues, and other administration priorities.

GENERAL FUND OUTLOOK

WHERE DO THE REVENUES COME FROM?



- Total revenues are \$3.7 billion for the 2009 biennium
- Income and property taxes comprise 65 percent of general fund revenues
- Total revenues increase \$202 million (5.8 percent) over the 2007 biennium

WHAT ARE THE AVAILABLE FUNDS FOR THE 2007 SESSION?

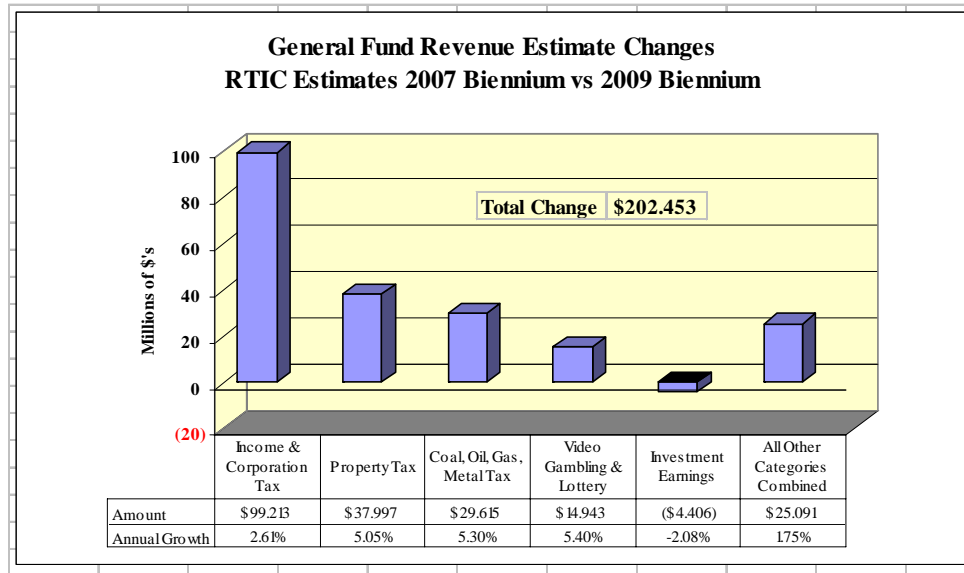
Projected ending fund balance after funding present law

- \$989.4 million available for tax policy/other new initiatives/fund balance reserve (Using LFD present law)

2009 Biennium General Fund Balance			
Present Law Only (In Millions)			
	Estimated Fiscal 2008	Estimated Fiscal 2009	Estimated 2009 Biennium
Beginning Fund Balance	\$530.778	\$687.038	\$530.778
Revenues			
Current Law Revenue	1,797.764	1,875.209	3,672.973
Total Funds Available	\$2,328.542	\$2,562.247	\$4,203.751
Disbursements			
General Appropriations			
Human Services	354.411	369.088	723.499
Corrections	164.283	169.317	333.600
Higher Education	161.550	166.385	327.935
Public Schools	604.165	615.467	1,219.632
Other Agencies	200.174	199.485	399.659
Statutory Appropriations	148.719	148.864	297.583
Non-Budgeted Transfers	9.126	9.310	18.436
Feed Bill Appropriations	2.280	8.740	11.020
Anticipated Reversions	(3.204)	(4.344)	(7.548)
Total Disbursements	\$1,641.504	\$1,682.312	\$3,323.816
Ending Fund Balance Before Reserve	\$687.038	\$879.935	\$879.935
Executive/LFD Present Law Difference	37.161	72.320	109.481
Ending Fund Balance With LFD Present Law	\$724.199	\$952.255	\$989.416
Proposed Executive Budget Reserve	(100.000)	(100.000)	(100.000)
Projected Present Law Surplus	\$624.199	\$852.255	\$889.416

Why so much?

- Growth over the 2007 biennium in:
 - Individual Income Tax
 - Corporate Tax
 - Oil and Gas Revenues
- After strong growth in FY 2004 through 2006, revenue growth is projected to return to a more historical pattern following a revenue surge
- Over \$500 million is considered one-time revenue
- Structural balance is maintained only if one-time revenues are used for one-time disbursements



- Caution: Growth in these categories may be subject to a future correction
- Reliance on sustaining current revenue levels may be over-optimistic
 - Individual Income Tax – high level of capital gains income: not likely to be sustained
 - Corporate Taxes – very volatile source: current projections at all-time high
 - Oil and Gas production – Based on record production and price: What is in the future?

EXECUTIVE BUDGET HIGHLIGHTS

- How does the Governor address the fiscal challenges of the state?
- What are his priorities?

TOTAL BUDGET OVERVIEW – GENERAL FUND

General Fund Balance Comparison 2007 & 2009 Biennium Figures in Millions			
	2007 Biennium	2009 Biennium	Biennial Change
Beginning Fund Balance	\$299.792	\$530.778	\$230.986
Revenue			
Estimated Revenue	3,470.521	3,749.568	279.047
Total Funds Available	\$3,770.313	\$4,280.346	\$510.033
Disbursements			
General Appropriations	2,935.036	3,729.625	794.589
Statutory Appropriations	271.646	306.583	34.937
Non-Budgeted Transfers	53.472	18.436	(35.036)
Feed Bill	8.633	11.020	2.387
Reversions	(48.476)	(7.548)	40.928
Total Disbursements	\$3,220.311	\$4,058.116	\$837.805
Fund Balance Adjustments	(19.224)		19.224
Balance Before Big Sky Savings Account	\$530.778	\$222.230	(\$308.548)
Big Sky Savings Account		122.230	122.230
Ending Fund Balance	\$530.778	\$100.000	(\$430.778)

- Governor's Budget proposes to spend \$4.1 billion in 2009 biennium
- No proposed tax increases
 - Some fee increases (\$8.4 million)
 - Emphasis on increased revenue auditing/compliance
- Tax reductions for business property tax, elimination of water tax
- Proposed one-time property tax rebate
- Amounts to \$837.8 million increase in spending (26.0 percent) over 2007 biennium
- Proposes to leave a \$100 million ending fund balance reserve
- Proposes to transfer approx. \$122.2 million to a budget stabilization account (rainy day fund)
- \$500 million in one-time expenditures, an unusually high number
 - Reflects, in large measure, the significant amount of non-recurring revenues
 - Spending on one-time items maintains structural balance in general fund

BUDGET PRIORITIES – GENERAL FUND

Revenue Proposals

- Revenue Increases
 - Dept. of Revenue Additional Auditing - \$15.4 million
 - Dept. of Revenue Compliance Legislation - \$57.2 million
 - Governor's Property Tax Rebate (state impact) - \$4.0 million

- Tax Policy Proposals (tax relief)
 - Personal Property Reduction – (\$30.0) million
 - Governor's Property Tax Rebate – (\$98.4) million
 - Water Tax Elimination/Rebate – (\$20.5) million

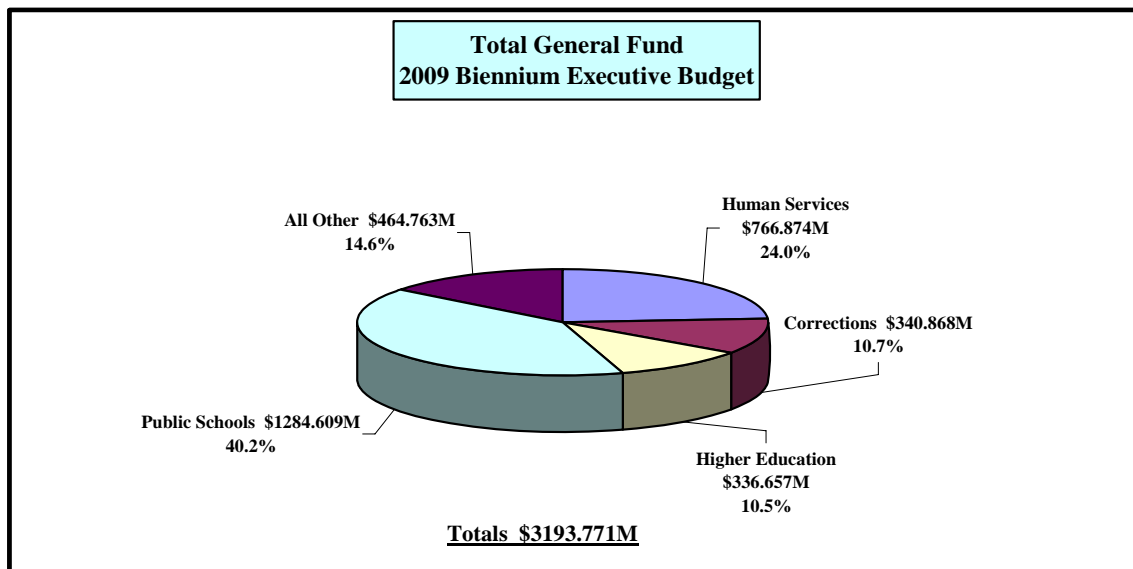
Expenditures - Legislation and other proposals other than HB2

The Governor proposes \$544.9 million (\$560.9 million if the Governor's emergency fund is included) in general fund increases outside of HB 2, including the tax policy proposals listed above (excluding most statutory appropriations and transfers). Most proposals are for one-time purposes (OTO), although over \$120 million would be ongoing. Specific proposals include:

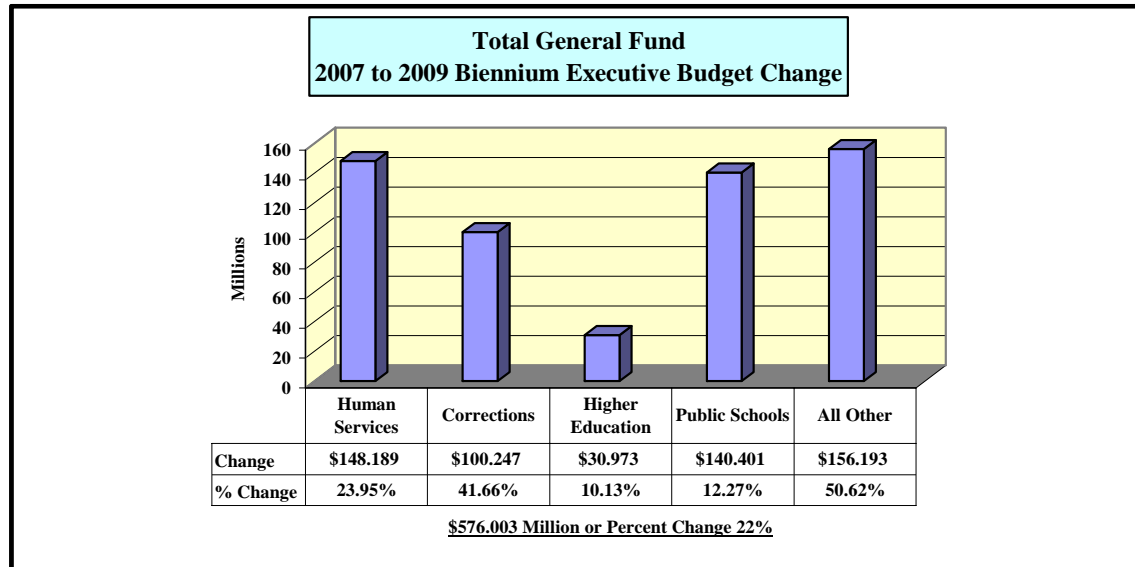
- Pension plan unfunded liability resolution
 - Direct fund infusion - \$100 million (OTO)
 - Increased employer share contribution - \$29.3 million
- Deferred infrastructure maintenance - \$66.5 million (OTO)
- Capital Projects - \$50.3 million (OTO)
- State employee pay plan - \$58.6 million
- Additional other emergency funding - \$9.0 million
- Property tax reserve fund - \$14.5 million (OTO)
- Capital Projects – IT - \$54.5 million

Expenditures - HB 2 General Fund

The Governor proposes \$3.2 billion in general fund expenditures in HB 2, shown in the following chart by major program category. This is a \$576 million increase over the 2007 biennium, or 22.0 percent.



The bar chart below shows the distribution of the \$576 million increase. "All Other" shows the largest increase, followed by human services, public schools, corrections, and higher education



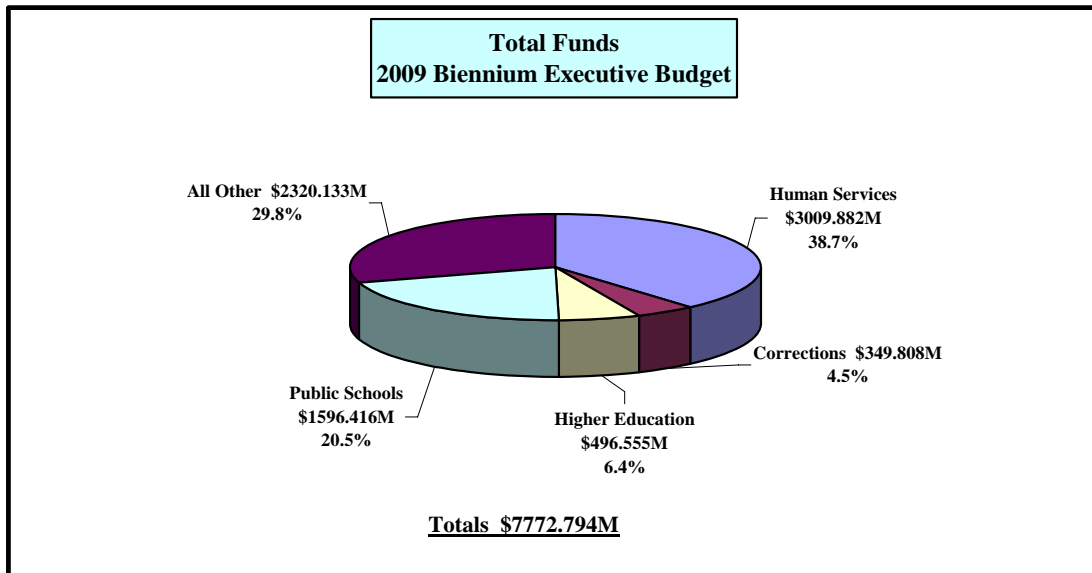
What is striking about the Governor's proposal is not only the size, but the breadth of the increases and initiatives. The smallest general fund increase for any executive agency is over 10 percent.

Major Proposed Adjustments:

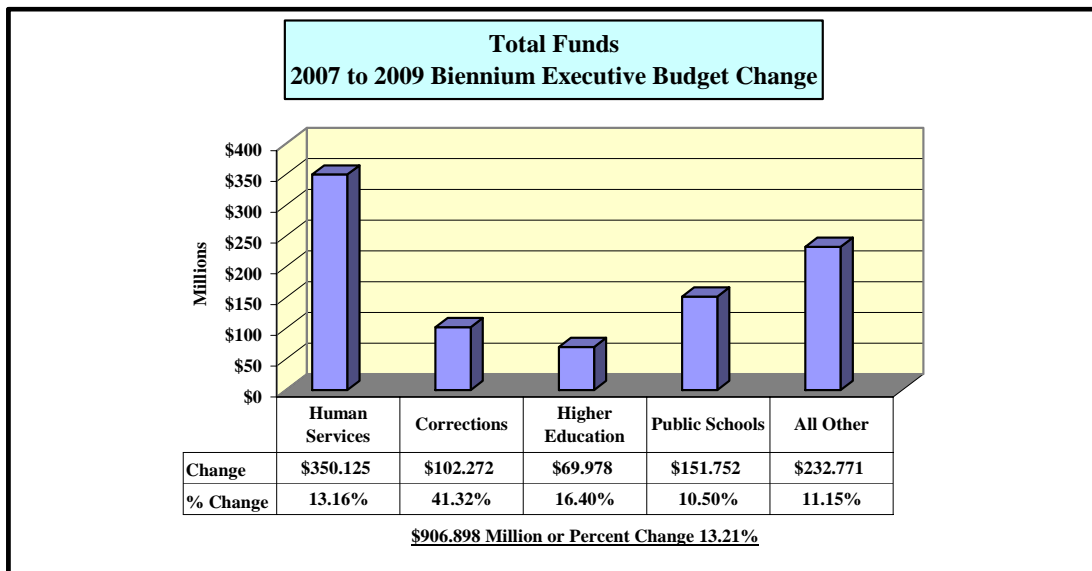
- All Other Category - \$156.2 million (50.6 percent increase)
 - The Department of Revenue, primarily for the cost of re-appraisal, tax compliance, and other tax administration (includes 102 FTE) - \$33.6 million
 - Maintenance and expansion of economic development programs - \$14.3 million (from the doubled FY 2006 base)
 - The new Office of the Public Defender - \$23.6 million
 - On-going deferred infrastructure maintenance and fire suppression - \$24.3 million
 - Statewide present law adjustments - \$58.3 million (from the doubled FY 2006 base, also included in the agency figures above and below)
- Human services, for maintenance of Medicaid and other human services, provider rate increases, and new initiatives such as mental health services for forensics patients and increased community services - \$148.2 million
- K-12, including maintenance of 2005 regular and special session additions, and increases in a number of areas, including full-time kindergarten, and facility improvements - \$140.4 million
- Corrections, primarily to address additional corrections population/overcrowding - \$100.2 million
- Higher education, to increase access through increased general fund support for present law adjustments, expanded student assistance, and transferability and high cost programs - \$31.0 million

BUDGET PRIORITIES - HB 2 - ALL FUNDS

All funds executive budget proposals total \$7.8 billion, shown on the following page, by major program category. The majority of all other is for Department of Transportation and natural resources agencies.



All funds increase by \$906.9 million from the 2007 biennium, or 13.2 percent.



Increases in total funds other than those for general fund described above are primarily in federal funds, of which human services would receive about 75 percent, primarily for Medicaid, food stamps, and other categorical grants.

OTHER FEATURES OF THE EXECUTIVE BUDGET

There are a myriad of issues that are discussed in more detail in various parts of the *Legislative Budget Analysis*. While these issues all relate to the overall executive proposal, some relate to statewide budget or policy issues, and some relate to budget process itself. Regardless, the following lists those issues in a brief format that are not presented above to make the reader aware of the bigger picture, but for more detail, the reader will need to dig deeper. The table of contents or index should provide a quick link to more detailed discussion. The Governor proposes:

- Supplemental appropriations in FY 2007 of \$76.4 million general fund
- A pay plan with a 3 percent per year salary increase beginning October 1 each year, and an increase in insurance contributions each year
- Making the “broadband pay plan” the state’s primary compensation system - the legislature may want to discuss the implications (significant growth in personal services expenditures)
- Increases in FTE of 454.38 in FY 2008 and 481.32 in FY 2009 over the FY 2006 level
- \$471 million in present law adjustments (which is \$100 million higher than LFD analysis would indicate - see issue on the following page)
- Over \$750 million in general fund new initiatives (new proposals – see present law issue discussed on the following page)
- Capital projects of \$304 million total funds, all paid with cash, and \$104.6 million in grants and loans
- No specific action to address any future potential K-12 legal action – the Governor has publicly stated he considers the school funding lawsuit issue resolved
- To directly budget for wildfire suppression costs for the first time
- Maintaining a \$100 million fund balance as a buffer to unforeseen expenditures needs or revenue shortfalls

BUDGET ISSUES

ISSUES WITH GOVERNOR'S BUDGET

- There is a significant expansion of state programs and services that may not be sustainable in the long-term
- Present law is overstated by at least \$100 million, including almost \$80 million that should have been requested as new proposals
- Some one-time proposals are in reality on-going
- Statewide present law adjustments include significant increases for implementation of the broadband pay plan, and the legislature needs to assess the level of control they will allow
- Several proposals phase-in costs that will be higher in the 2011 biennium
- There are many items in the proposed executive budget that are not fully developed and lack the specific information needed for a comprehensive and sometimes even adequate analysis of the budget proposal
- The questionable procedure of transfers from the general fund to other funds in the 2009 biennium are estimated to be up to \$33.7 million
- There are numerous issues with regard to measurable goals and objectives for the budget increases requested

ISSUES NOT DIRECTLY RELATED TO THE EXECUTIVE BUDGET

- The highways special revenue account fund balance is not sustainable in the long-term, and future federal funding levels for highways is uncertain
- The State Fund "old fund" is underfunded and will eventually have to be supported by general fund
- Legislators need to be aware of pending lawsuits related to the State Fund, lease payments by dam owners, and protested taxes that all have general fund implications
- The long-term stability of the general fund is an issue that must be examined for development of sound fiscal policies
- Regarding the state's reliance on federal funds, the prospect for federal funding freezes or reductions is a real possibility, not only in the near-term but also in the long-term
- Regarding wildfire suppression, there are two issues: 1) the cost of suppression operations has increased, and 2) federal participation is declining
- The legislature fails to budget for anticipated wildfire costs and does not include the statutory emergency appropriation or anticipated wildfire costs in the projections of ending fund balance, resulting in an over-stated fund balance reserve.